COMPANY RESEARCH AND ANALYSIS REPORT

Samty Co., Ltd.

3244

Tokyo Stock Exchange First Section

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Summary

Steady growth in Real Estate Business thanks to tailwind from strong real estate market; raises earnings and dividend forecasts for FY11/17

1. Company profile

Samty Co., Ltd. <3244> (hereafter, also “the Company”) is a comprehensive real estate company that operates a nationwide business, centered on the Kansai and metropolitan Tokyo regions. Its business is based on the twin axes of its Real Estate Business (development and sales of large-scale leasing condominiums for real estate funds and income condominiums for investors) and Property Leasing Business (including leasing condominiums and commercial facilities), while it also manages business hotels and other related operations. A feature of the Company is that it is able to respond flexibly to changes to its business environment from its balance of realizing stable income from its Property Leasing Business and accelerating growth from its Real Estate Business, and it achieved sustainable growth even while overcoming major financial crises. It also has a superior business model in which it combines both businesses to handle every aspect of the property business, and presently it is continuing to achieve high growth. In June 2015, it entered into the J-REIT business*, and in October 2015, its listing was changed from the Tokyo Stock Exchange (TSE) JASDAQ to the TSE First Section. So the Company has solidified the foundations of its business model for further business expansion. It is entering a new growth phase supported by a favorable business environment.

* Samty Residential Investment Corporation <3459> (hereafter, “SRR”), which was established in March 2015, is listed on the TSE J-REIT market.

2. Medium-term management plan

The Company’s current medium-term business plan covers the five-year period from FY11/16 to FY11/20. The plan targets net sales at the ¥100bn level and ordinary income at the ¥10bn level for FY11/20, based on three key strategies: (1) Development of a business model centered on Samty Residential Investment Corporation <3459> (hereafter, “SRR”); (2) Strategic investment in regional metropolitan areas; and (3) Roll-out of the hotel development business. In addition, investment of about ¥300bn is planned over the five years from FY11/16 to FY11/20.

3. Business result for FY11/17 1H

Looking at business results for 1H FY11/17, sales and profits rose by more than expected, with sales up 76.9% year on year (YoY) to ¥37,692mn and operating income up 104.1% YoY to ¥6,928mn. Amid a strong real estate market, rising sale prices in the Real Estate Business contributed to earnings growth. Additionally, procurement of development sites and income properties has been progressing in line with the full-year plan.

4. FY11/17 forecast

Based on 1H results and recent conditions, the Company raised its FY11/17 earnings forecasts from their original levels. It now forecasts sales of ¥62,000mn, up 18.3% YoY (¥800mn higher than previous forecast) and operating income of ¥10,300mn, up 20.0% YoY (¥1,000mn higher). Regarding the year-end dividend, the Company plans to pay a dividend of ¥42 per share, a YoY increase of ¥9 (¥6 higher than previous forecast). As for investment plans, the Company plans to invest a total of about ¥42.3bn, comprising about ¥15.8bn for development sites and about ¥26.5bn for income properties. Based on 1H results, its pipeline of development sites, and acquisitions of income properties, we believe the Company will be able to reach its targets. We believe market trends and progress toward the Company's targets bear monitoring, as we see further potential upside and earnings growth from FY11/18 onward.

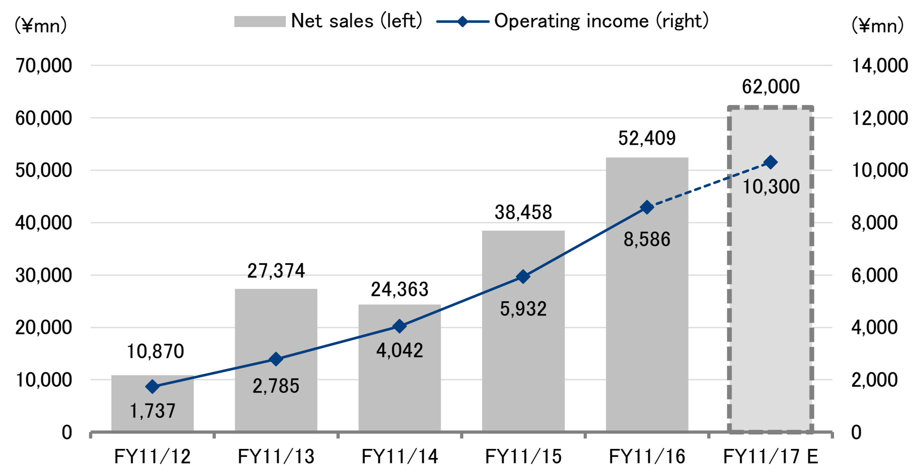
5. Medium-term outlook

At FISCO, we think that the Company can maintain its high growth over the medium to long term as the conditions in both its external and internal environments are supporting its growth. However, there are questions that should be paid attention to. Firstly, in the context of the difficulty in purchasing land, particularly in metropolitan areas, how will it accumulate development sites (pipeline)? Second, how will it discover and increase the value of income real estate with high yields, especially in major regional cities? Finally, in what ways will constructing a business model centered on SRR change the Company's profitability and growth potential?

Key Points

- Achieved greater-than-expected growth in sales and profit in 1H FY11/17
- Raised FY11/17 earnings forecast and year-end dividend forecast
- Focusing on building business model focused on SRR, investment in regional metropolitan areas, and progress in hotel development business

Results trends



Source: Prepared by FISCO from the Company's financial results

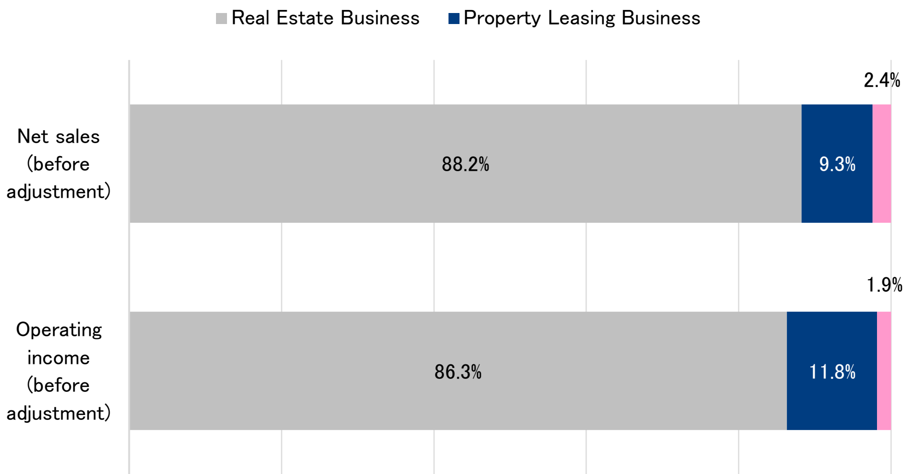
Company profile

Balanced business portfolio based on Real Estate Business and Property Leasing Business; entered J-REIT business in June 2015

1. Business overview

The Company has three business segments; the Real Estate Business, the Property Leasing Business, and the Other Business. The Real Estate Business contributes 88.2% of net sales and 86.3% of operating income (FY11/17 1H results). However, it is necessary to be aware that in contrast to the steady growth of the Property Leasing Business, results in the Real Estate Business tend to increase and decrease greatly due to various factors, including the business environment. Since its foundation, the Company's strength has been its leasing capabilities in its area of expertise of residential properties (condominiums, etc.), that can be expected to stably maintain high occupancy rates.

Percentages of net sales by business (FY11/17 1H)



Source: Prepared by FISCO from the Company's financial results

Also, in March 2015 it established SRR, which was listed on the TSE J-REIT market in June of the same year. The Samty Group plays the role of sponsor of SRR (supplying it with properties) and is responsible for the subsequent asset management and other operations. SRR's current asset scale is in excess of ¥52bn (as of the end of July 2017).

For its sales bases, in addition to its Osaka head office (Yodogawa-ku), it has branch offices in Tokyo (Chiyoda-ku), Fukuoka (Hakata-ku), Sapporo (Chuo-ku) and Nagoya (Nakamura-ku), and it is establishing a nationwide system centered on the major regional cities.

The Samty Group is comprised of the Company and 13 consolidated subsidiaries, but in the processes carried out for the Real Estate Business and Property Leasing Business, this includes 8 special purpose companies (SPC) and general incorporated associations established and invested-in in relation to schemes to acquire, own, and develop land, properties, and trust beneficiary rights. The main consolidated subsidiaries include Samty Asset Management Co., Ltd. (asset management, etc.), Suntoa Co., Ltd. (hotel management, etc.), and Samty Kanri Co., Ltd. (property management, maintenance, etc.) (as of the end of May 2017).

Samty Kanri Co., Ltd. was renamed as Samty Property Management Co., Ltd. on December 1, 2016, in conjunction with the integration and realignment of the Samty Group's property management (PM) functions. The Samty Group is strengthening its hand in promoting PM operations entrusted from J-REITs and real estate funds, beginning with assets owned by SRR. By capturing Group-wide synergies as a comprehensive real estate business, the Group aims to drive earnings growth over the medium to long term.

Overviews of each business are as follows.

(1) The Real Estate Business

This business supports the Company's growth and is divided into four sub-segments; "development mobilization," "regeneration mobilization," "condominiums for investment," and "asset management."

"Development mobilization" refers to the planning, development, and sales of leasing condominiums for real estate funds (including of the S-RESIDENCE series, which is the brand developed by the Company). Basically, the properties are large-scale, one-room condominiums with a total number of around 200 units, and include features such as stairwell entrances and sophisticated designs. Recently, demand has been considerable from real estate funds and other clients regardless of building size, so sales of medium-sized properties have also increased. The Company has granted SRR preferential transaction negotiating rights (first refusal rights) for the S-RESIDENCE series and going forward, its policy is to mainly supply properties to SRR.

The S-RESIDENCE series

Source: The Company's website and materials supplied by the Company

"Regeneration mobilization" refers to the regeneration and sales of existing income properties. The Company aims to improve occupancy rates by utilizing its leasing capabilities and expertise for the income properties and upgrading properties through renovating facilities, which generates earnings over the period of ownership. In addition, its final objective is to record gains on sales through selling its holdings and investment properties to real estate funds, business companies, and wealthy individuals. It also carries out warehousing* for SRR. During the ownership period, leasing income is recorded in the Property Leasing Business.

* Properties acquired to incorporate into REIT

"Condominiums for investment" involves the planning, development, and sales of one-room condominiums for investment, mainly to individual investors. A feature of the Company is that it does not have an in-house sales team, and it conducts wholesales (selling units and buildings) to sales companies. Through building a network with sales companies that have a sales track record in the business area and consulting with sales companies at the planning and development stages, it is able to supply properties that meet client (user) needs. Also, excluding the metropolitan Tokyo region, which has an active trend of "green-field purchases" by sales companies due to their sense of the scarcity of properties, the Company's excellent leasing expertise (wholesale sales after leasing a property) differentiate it from its competitors and results in it being trusted by and having negotiating power with the sales companies.

The objectives of "asset management" are obtaining commission income, from the Company being commissioned (outsourced) to operate and manage real estate as the asset manager by real estate funds, and also dividend income from the Company's own investments in real estate funds. Through the smooth launch of SRR, it would seem that the asset management business will also expand in the future, alongside the expansion in the asset scale of SRR. The revenue structure in this business comprises management commissions (0.45% of the balance of assets under management), acquisition commissions (1.0% of the property acquisition value), sales commissions (0.5% of the property sales value) and other components. Notably, management commissions can be expected to provide a source of steady revenue every fiscal year based on the balance of assets under management.

(2) Property Leasing Business

This business is the foundation that ensures stability, and the segment profit margins are also maintaining high levels. It owns around 83 properties nationwide, centered on the Kansai and metropolitan Tokyo regions and government ordinance designated cities such as Fukuoka, Sapporo, and Nagoya. In addition, it conducts diversified investment in a variety of assets, including condominiums, office buildings, and commercial facilities. Breaking down its properties according to type of facility, condominiums constitute 68.3% of the total floor space, offices 7.2%, and commercial, logistics and related facilities 24.5%, so the weights are high for condominiums that have stably high rates of occupancy. The Company utilizes its leasing expertise to realize high occupancy rates above 90% when averaged over the year. The occupancy rates according to facility are 90.0%* for condominiums, 89.1% for offices, and 95.6% for commercial, logistics and related facilities. While the scale of the real estate it owns amounts to around ¥85.3bn (carrying amount), this is divided into ¥24.6bn of inventory assets that it intends finally to sell (real estate for sale), and ¥60.4bn of tangible fixed assets that it intends to continue to own (all results are from the end of May 2017). In addition to its main commercial facilities, such as the historic Amanohashidate hotel, these assets included properties such as Pieri Moriyama, a large scale commercial facility on Lake Biwa that was reopened in December 2014.

* Including new acquisitions with occupancy rates of 0%

(3) Other Business

This business mainly involves hotel management, a condominium management business, and a construction and renovation business. In the hotel business, it owns and manages Center Hotel Osaka (Chuo-ku, Osaka, 84 rooms) and the S-PERIA Hotel Nagasaki (Nagasaki, 153 rooms). In addition, it manages Center Hotel Tokyo (Chuo-ku, Tokyo, 107 rooms), which was sold (and leased back) in FY11/16. Center Hotel Tokyo and Center Hotel Osaka are man-aged by its subsidiary, Suntoa. Also its subsidiary Samty Property Management conducts operations including condominium management (mainly the Company's condominium properties but also including external properties), and a construction and renovation business.

2. Features

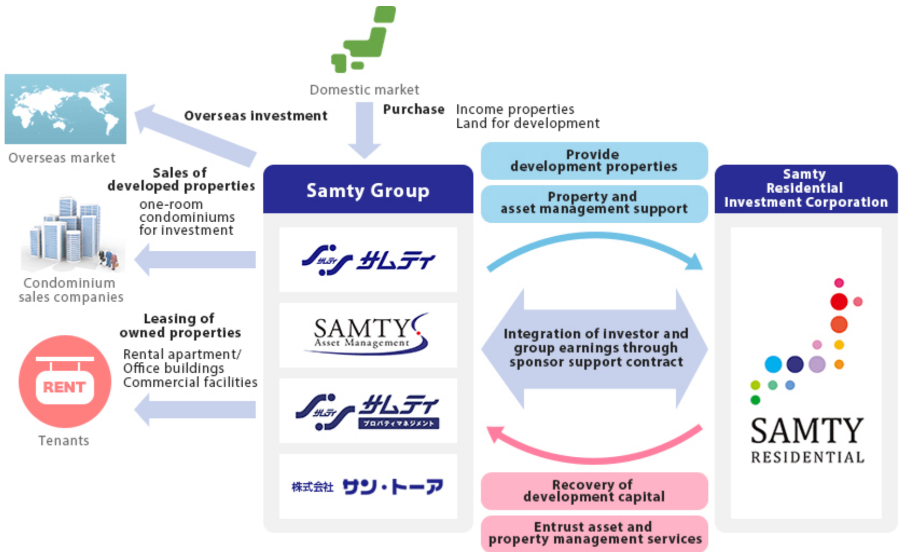
A feature of the Company is that its business model combines its two businesses, the Real Estate Business and the Property Leasing Business, to give it the capability of handling all aspects of the property business. This forms its strength in terms of the superiority of its business and revenue structure.

(1) A superior business model

A feature of the Company's business model is that every phase of the property business, of land purchases, development, leasing, sales, and after-sales, are conducted within the Group, and by connecting these respective functions, it creates value (a value chain) that is unique to the Company. In particular, it utilizes its sophisticated leasing expertise, which it has cultivated in the Property Leasing Business, in the Real Estate Business also. In addition to improving the value of income properties, this has positive effects for the superiority of its bargaining power when purchasing land, as well as for establishing relationships based on trust and negotiating with buyers.

Following the smooth launch of SRR, going forward the Company is aiming to construct a business model centered on SRR. In addition to having a stable destination to supply its properties, it is considered that SRR will contribute to the further evolution of its business model, including expanding its after-sales fee business (as an outsourcer for asset management and property management operations).

Business model overview



Source: Excerpted from the Company's website

(2) The profit structure as a strength

One of the Company's strengths is that it can respond flexibly to changes to its business environment while maintaining a balance between stable income from its Property Leasing Business (a stock business) and growth acceleration from its Real Estate Business (a flow business). In other words, during a period of economic recession, its results can be supported by its Property Leasing Business, and then during a period of economic expansion (recovery), it can accelerate its growth through its Real Estate Business. In addition, its ability to withstand periods of recession is strengthened by the fact that it keeps down fixed costs by not having an in-house sales team and instead utilizing external resources (it has networks and expertise to do so). The reasons why in the financial crises up to the present time (such as following the collapse of the bubble economy and from the impact of the 2008 financial crisis), its results deteriorated comparatively little, is due to the fact that they were supported by its Property Leasing Business and the fact that it kept its fixed costs down. On the other hand, in the current situation of a continuingly favorable business environment, the Real Estate Business is the main driving force behind the growth in the Company's results.

3. History

The Company was established in December 1982 in Higashiyodogawa-ku, Osaka, as Samty Development Co., Ltd. (it changed to its current company name in June 2005). Centered on three people, Mr. Shigeru Moriyama (current chairman), Mr. Ichiro Matsushita (current vice chairman), and Mr. Kiyoharu Taniguchi, it launched a real estate sales, leasing, and management business. It initially started from consignment sales of condominiums, but subsequently it steadily accumulated results in areas such as sales of condominium buildings for investment and sales of units in condominium buildings for families.

After launching sales in May 2001 of its Samty series of one-room condominiums for investment, in March 2005 it launched sales of its S-RESIDENCE series of leasing properties for real estate funds, which spurred on its business expansion. In August 2006, it entered into the hotels business by acquiring the shares of Suntoa, which owns and manages business hotels. In July 2007, it was listed on the Osaka Hercules market (currently, the TSE JASDAQ market).

Next, in order to further expand its business and disperse it over different regions, it opened branch offices in Tokyo in February 2011, in Fukuoka in June 2012, in Sapporo in May 2015, and in Nagoya in March 2016, and over this 5-year period it steadily expanded the regions in which it does business.

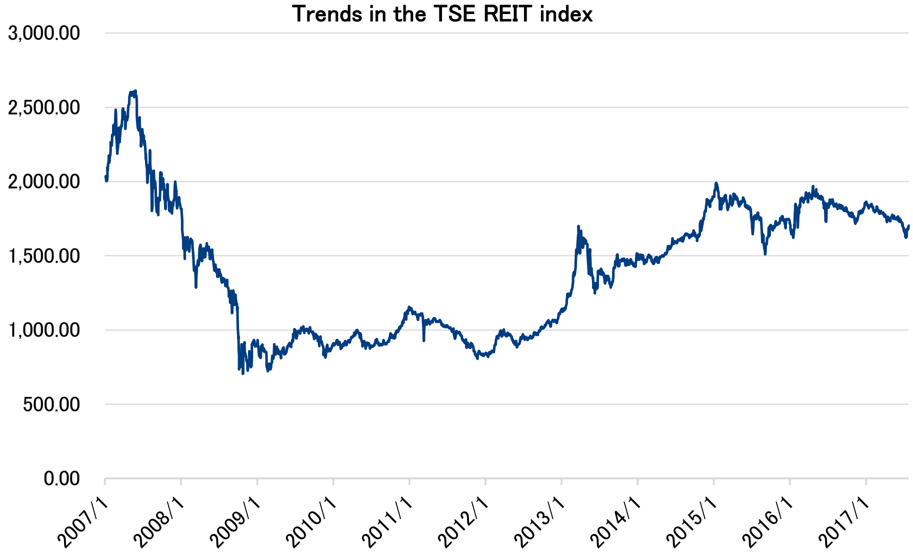
The Company has also actively taken steps to expand its business area. In August 2006, it acquired the shares of Suntoa, which owns and manages business hotels (to enter into the hotels business). In December 2011, it established Samty Kanri (to enter into the property management business); in November 2012, it made Samty Asset Management a wholly owned subsidiary; and in June 2015, Samty Residential Investment Corporation was listed on the TSE J-REIT market. In such ways, it has established a system for growth to accelerate in the future. Its listing was changed to the TSE First Section in October 2015.

Industry environment

Steady expansion in the J-REIT market

The J-REIT market will have an important influence on the Company's growth strategy in the future. As of the end of May 2017, its market capitalization stood at around ¥11,786.6bn, and there were 58 J-REITs listed. Although there was a phase in which the market was temporarily sluggish due to the impact of the credit tightening and related factors following the 2008 financial crisis, since 2012 it has steadily trended upward thanks to the recovery of the domestic economy and the effects of long-term monetary easing. Further, recently there has been a diversification of investment targets, such as hotels and commercial facilities with an eye to the increase in inbound demand, long-term care facilities that are being built in response to the aging of society, and logistics facilities and infrastructure (solar power plants, etc.) So a variety of investment opportunities are being created, yet at the same time there remains considerable room for the market to grow.

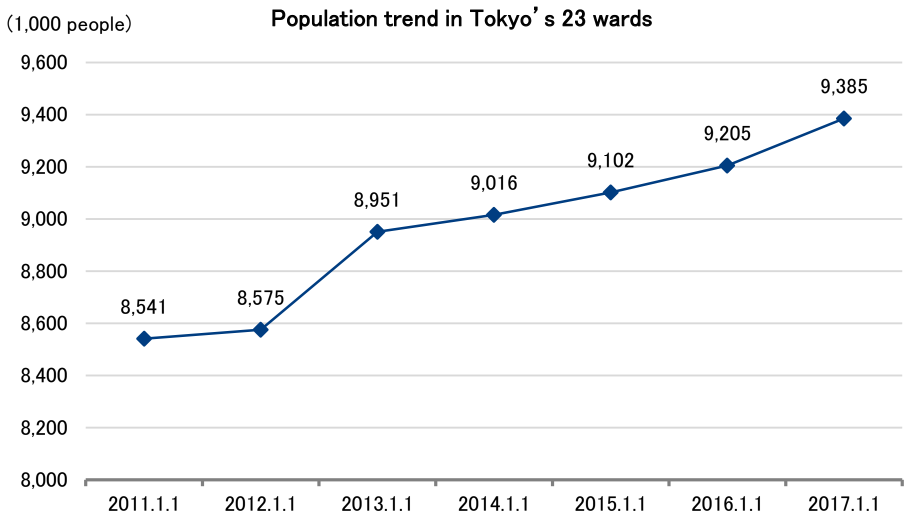
Trends in the TSE REIT index



Source: Prepared by FISCO from various materials

Recently, the TSE REIT index has shown moderately weak performance amid rising global interest rates and concerns regarding deterioration of the supply-demand balance owing to a large supply of office space expected to go on the market in 2018. However, demand for J-REITs remains strong from domestic and overseas institutional investors seeking strong yields and relatively stable cash flow based on the view that the Bank of Japan will maintain its policy of monetary easing and office demand will rise. Since the implementation of monetary easing by the Bank of Japan, 10-year JGB yields have fallen sharply and there has been a sizable, continuous inflow of money into J-REITs, which have relatively high expected yields (recently around 4%). In addition, the medium-term outlook for J-REITs looks strong amid continued monetary easing and a strong real estate market (improving vacancy rates and rising rents).

On the other hand, the market for condominiums for investment is also trending favorably, supported by the strong demand from both tenants (users) and investors. According to data published by the Tokyo Metropolitan Government Bureau of General Affairs, the population of Tokyo's 23 wards, which constitutes most of the region to which the Company supplies properties, is continuing to increase against the backdrop of the large number of people moving to metropolitan Tokyo. In particular, there has been an noticeable increase in the number of single-person households, which is occurring in the context of later marriages and the increase in the divorce rate, in addition to the young, and it is thought that this will also support lease demand for one-room condominiums in the future. This trend can be seen not only in Osaka and Nagoya, but also in regional metropolitan areas such as Fukuoka and Sapporo, and while on one hand the population of Japan is declining, on the other hand it continues to be concentrated into cities. On the investor side also, demand is increasing from individual investors in their twenties and thirties who are anxious about their futures in terms of their pensions and lives in their old age, and also from the elderly as an inheritance-tax measure following the reduction in the basic exemption amount.



Source: Prepared by FISCO based on materials issued by the Tokyo Metropolitan Government Bureau of General Affairs

In addition, the financial environment surrounding the real estate industry is proving to be a tailwind. According to a survey by the Bank of Japan, new lending to the real estate industry in fiscal year 2016 grew 9.6% YoY to ¥12,357.7bn (a new record high), and the positive attitudes of financial institutions toward real estate financing has been noticeable. The loans balance also reached a new record high of ¥72,296.8bn at the end of March 2017.

Conversely, the problems that the industry is facing include that it has become more difficult to purchase land in city centers due to financial institutions actively conducting real estate financing and the resulting increase in the number of players, and also the rise in land prices and soaring construction costs.

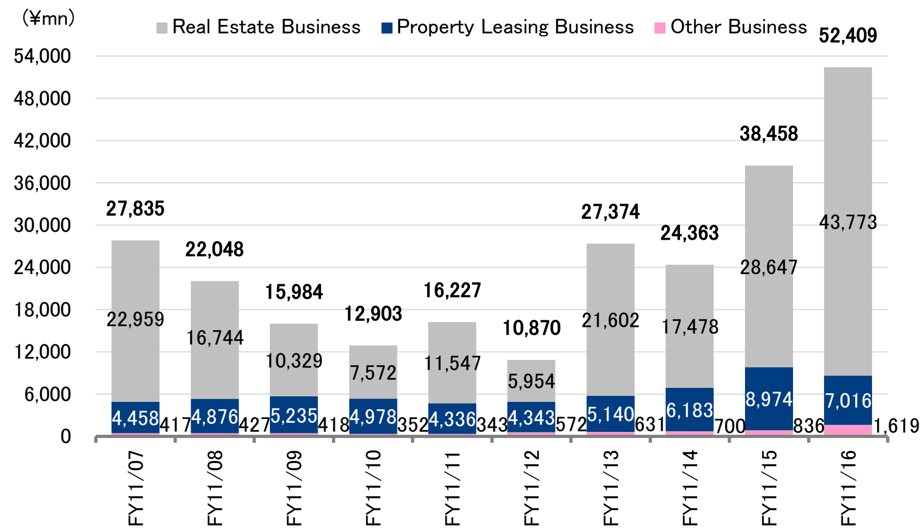
Results trends

Stable growth in Real Estate Business amid strong real estate market

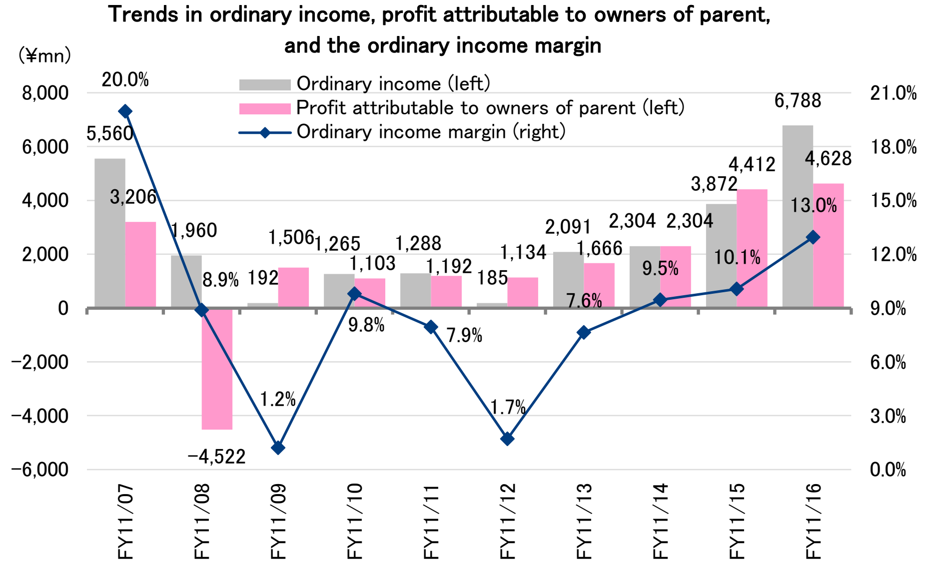
1. Past results trends

Looking back on the Company's results since FY11/07, which was the year it listed on the Osaka Stock Exchange Hercules market (currently, the TSE JASDAQ market), immediately after it listed it was impacted by the 2008 financial crisis, and there was a period in which its results trended at a low level. The major contraction of its Real Estate Business due to the credit tightening by financial institutions had a particularly adverse impact on its results. However, the points we should focus on are that results in the Property Leasing Business have trended stably even when within a severe industry environment, which has supported the results of the Company as a whole. The fact that it does not have its own in-house sales team and has kept down fixed costs has also had a positive effect, and it can be highly evaluated on the point that it has secured profits in every fiscal year expect FY11/08, when it recorded a net loss due to declaring impairment.

Trends in net sales (by business)



Source: Prepared by FISCO from the Company's financial results
Note: Excluding internal sales



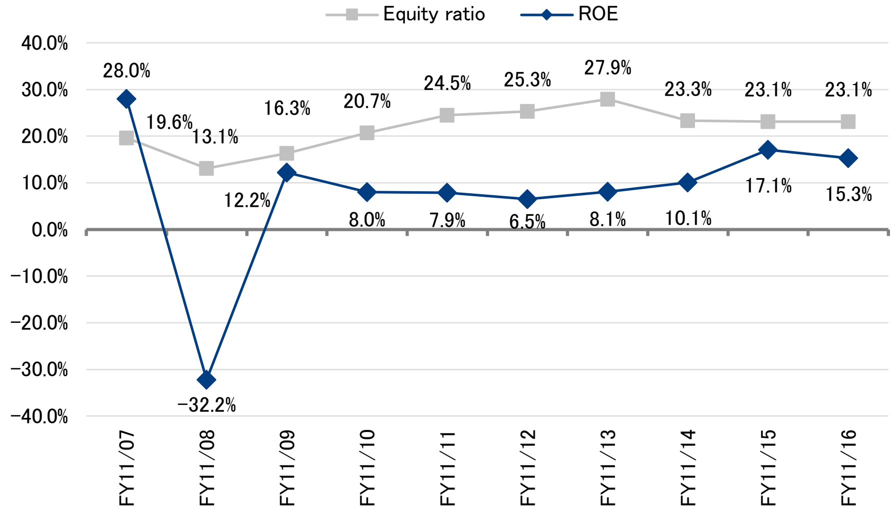
Source: Prepared by FISCO from the Company's financial results

Since FY11/13, the Real Estate Business has greatly recovered due to the change in financial institutions' attitude toward financing, which has occurred against the backdrop of the recovery of the domestic economy and monetary easing, and the Company's results have entered an expansion phase. In terms of profit and loss also, the ordinary income margin has been improving year by year thanks to the growth in the highly profitable development mobilization and investment condominium sales, and in FY11/16 it reached the high level of 13.0%.

The equity ratio has trended at a level of around 25%. In FY11/13, it rose to 27.9% following the implementation of a capital increase through a public offering (approximately ¥2bn), but since FY11/15, it has fallen to a level of around 23% due to the Company's active accumulation of assets and other factors. One issue it will need to address in the future would seem to be strengthening its financial base toward growth.

On the other hand, ROE, which indicates capital efficiency, has trended upward alongside the improvement in the profit margin. In FY11/16, it had reached the high level of 15.3%.

Trends in the equity ratio and ROE



Source: Prepared by FISCO from the Company's financial results

Posted greater-than-expected growth in sales and profit in 1H FY11/17

2. Overview of the FY11/17 1H results

In terms of FY11/17 1H results, sales and profits increased significantly and significantly above the forecast. Net sales increased 76.9% YoY to ¥37,692mn and operating income rose 104.1% to ¥6,928mn. Ordinary income was up 157.7% to ¥6,115mn and profit attributable to owners of parent rose 147.2% to ¥4,307mn.

Net sales rose sharply on strong property sales in the Real Estate Business. Sales in the regeneration mobilization (regeneration and sales of existing income properties) and condominiums for investment (planning, development, and sales of condominiums for investment) categories surpassed expectations on strong demand from investors. Results in the Property Leasing Business were also firm.

In terms of profit and loss, the cost-of-sales ratio rose owing to higher depreciation costs resulting from the acquisition of a large income property, but this was in line with expectations. SG&A expenses also rose slightly owing to the airing of a television commercial aimed at increasing the Company's name recognition, but the Company was still able to achieve strong profit growth on higher sales and higher sale prices in the Real Estate Business and operating income rose by a strong 18.4% YoY (15.9% growth in 1H FY11/16).

Looking at land purchases, the Company acquired 12 development sites (estimated sales value of ¥17.0bn), and 21 income properties. This represents roughly 50% progress toward both of the Company's full-year acquisition targets (¥15.8bn in development properties and ¥26.5bn in income properties).

Turning to the Company's financial condition, while fixed assets rose owing to the acquisition of income properties, sale of properties for sale proceeded smoothly and total assets declined slightly (down 0.8% versus end-FY11/16) to ¥139,995mn. In conjunction with this, interest-bearing debt declined to ¥91,584mn (down 4.1%) and shareholders' equity rose to ¥36,131mn (up 11.0%) due to an increase in accumulation of internal reserves. As a result, the equity ratio improved to 25.8% (23.1% at end-FY11/16).

Overview of operating results

(¥mn)

	FY11/16 1H Result		FY11/17 1H Result		Change	
		% of total		% of total		%
Net sales	21,311		37,692		16,380	76.9%
Real Estate Business	17,112	80.3%	33,457	88.8%	16,345	95.5%
Property Leasing Business	3,473	16.3%	3,537	9.4%	64	1.9%
Other Business	802	3.8%	918	2.4%	115	14.4%
Adjusted amount	-76	-	-221	-	-145	-
Cost of sales	15,633	73.4%	28,206	74.8%	12,572	80.4%
SG&A expenses	2,283	10.7%	2,558	6.8%	274	12.0%
Operating income	3,394	15.9%	6,928	18.4%	3,534	104.1%
Real Estate Business	2,978	17.4%	7,137	21.3%	4,158	139.6%
Property Leasing Business	1,236	35.6%	977	27.6%	-258	-20.9%
Other Business	195	24.3%	155	16.9%	-39	-20.3%
Adjusted amount	-1,016	-	-1,343	-	-326	-
Ordinary income	2,373	11.1%	6,115	16.2%	3,742	157.7%
Profit attributable to owners of parent	1,742	8.2%	4,307	11.4%	2,564	147.2%
Real Estate Business net sales	17,112		33,457		16,345	95.5%
Development mobilization	4,730		4,902		172	3.6%
Regeneration mobilization	7,958		20,129		12,171	152.9%
Condominiums for investment	3,926		8,202		4,276	108.9%
Asset management	491		154		-336	-68.5%

Source: Prepared by FISCO from the Company's financial results and financial results briefing materials.

Financial position

(¥mn)

	End of November 2016	End of May 2017	Change
Current assets	85,981	73,995	-11,985
Cash and deposits	21,789	23,081	1,292
Real estate for sale	39,514	24,629	-14,884
Real estate for sale under construction	22,940	24,836	1,895
Non-current assets	55,048	65,883	10,834
Property and equipment	50,606	60,495	9,889
Intangible assets	151	141	-10
Investments and other assets	4,290	5,246	956
Total assets	141,170	139,995	-1,174
Current liabilities	28,439	27,839	-599
Short-term borrowings	10,279	6,575	-3,704
Current portion of long-term debt	11,205	14,406	3,200
Non-current liabilities	79,884	75,698	-4,186
Long-term debt	74,083	70,603	-3,480
Bonds with subscription rights to shares	1,435	1,420	-15
Net assets	32,847	36,457	3,610
Total liabilities and net assets	141,170	139,995	-1,174
Interest-bearing debt	95,568	91,584	-3,983
Shareholders' equity	32,551	36,131	3,580
Equity ratio	23.1%	25.8%	2.7P

Source: Prepared by FISCO from the Company's financial results and financial results briefing materials.

The results according to business are as follows.

(1) Real Estate Business

In the Real Estate Business, net sales increased by 95.5% YoY to ¥33,457mn and segment income increased steadily by 139.6% to ¥7,137mn, outpacing expectations for growth in sales and profit. In particular, regeneration mobilization sub-segment sales rose sharply, increasing by 152.9% YoY to ¥20,129mn. 19 properties were sold (versus 8 properties in 1H FY11/16) and the rise in sale prices contributed to earnings growth. Sales of investment condominiums also rose a strong 108.9% YoY to ¥8,202mn on strong demand from individual investors, as the Company sold 11 properties and 473 units (compared with 9 properties and 260 units in 1H FY11/16). Development mobilization sub-segment sales rose steadily, increasing by 3.6% YoY to ¥4,902mn. The Company sold three properties in the S-RESIDENCE series (versus two in 1H FY11/16), including two sold to a bridge fund in order to supply them to SRR and one to an overseas investor (the Company has been receiving many inquiries from overseas investors). The decline in asset management sales (down 68.5% YoY to ¥154mn) is attributable to a removal of one-off factors in 1H FY11/16.

In terms of profit and loss, the segment profit margin improved considerably to 21.3% (versus 17.4% in 1H FY11/16) on the rise in sale prices, resulting in a sizable increase in profit.

(2) Property Leasing Business

In the Property Leasing Business, sales rose but profit declined, with net sales increasing 1.9% YoY to ¥3,537mn and segment income decreasing 20.9% YoY to ¥977mn. While the sale of 19 income properties had a negative impact on leasing income, sales increased owing to the acquisition of 21 new properties. As the timing of these acquisitions was brought forward, this resulted in a greater-than-expected increase in leasing income. In terms of profit and loss, the decline in profit from an increase in depreciation costs associated with the acquisition* of a large-scale property was in line with expectations.

* Including Samty Kego Tower (a high-rise condominium building in Fukuoka), which was acquired on November 29, 2016.

(3) Other Business

In the Other Business segment, sales increased but earnings declined, with net sales increasing 14.4% YoY to ¥918mn and segment income declining 20.3% YoY to ¥155mn. Sales rose from an increase in construction orders and an increase in the number of condominiums under management. However, we understand that factors having a negative impact on profit and loss included 1) leasing costs for Center Hotel Tokyo, a property which was sold off (and leased back) and is currently managed (but not owned) by the company, 2) a removal from a highly profitable project in the previous fiscal year, and 3) a slight decline in the occupancy rate* at hotels managed by the company. The low occupancy rate at S-PERIA Hotel Nagasaki was attributable to the winding down of temporary demand related to shipbuilding work in the area and an increase in lodging prices. This hotel has long had a high occupancy rate and has successfully secured a new guest acquisition channel. We therefore believe that any negative earnings impact from this hotel in the future will be limited.

* End-May 2017 occupancy rates: Center Hotel Tokyo: 90.6% (95.5% at end-May 2016), Center Hotel Osaka: 85.2% (86.3%), S-PERIA Hotel Nagasaki: 76.5% (76.0%)

As a result of the above, 1H earnings were strong overall as 1) Real Estate Business earnings grew at a faster pace than expected with tailwind support from a strong real estate market and 2) the company made steady progress on acquisitions to drive future growth (development properties and income properties).

3. The development plan (pipeline) situation

Looking at the development status of the S-RESIDENCE series, a total of 15 properties (1,550 units) are under development, comprising 9 properties (927 units) scheduled to be completed in 2017, 5 properties (470 units) scheduled to be completed in 2018, and 1 property (153 units) scheduled to be completed in 2019. On an expected sale price basis, S-RESIDENCE series value is roughly ¥22bn*. There are 4 properties in the Tokyo metropolitan area (1 in Tokyo, 1 in Kanagawa Prefecture, 2 in Chiba Prefecture), 8 properties in the Kansai region (in Osaka Prefecture) and 2 properties in Aichi Prefecture (in Nagoya) and 1 property in Hokkaido (in Sapporo).

* The S-RESIDENCE Miyanomori in Hokkaido is not included in the properties intended for sale total because the Company intends to hold the property as a fixed asset.

S-RESIDENCE development and sales plan
(at the end of May 2017)

Fiscal year of completion	Property name or project name	Location	No. of units	First refusal rights*
2017	S-RESIDENCE Fukaebashi EAST II	Higashinari-ku, Osaka	96	○
	S-RESIDENCE Shin-Osaka WEST	Yodogawa-ku, Osaka	224	○
	S-RESIDENCE Kawasaki Kaizuka	Kawasaki-ku, Kawasaki	43	○
	S-RESIDENCE Esaka II	Tarumicho, Suita	75	○
	S-RESIDENCE Miyakojima	Miyakjima-ku, Osaka	120	○
	S-RESIDENCE Tanimachi 5-chome	Chuo-ku, Osaka	84	○
	S-RESIDENCE Nagoya-shi Naka-ku	Naka-ku, Nagoya	109	○
	S-RESIDENCE Miyanomori	Chuo-ku, Sapporo	22	-
	S-RESIDENCE Minami-Horie	Nishi-ku, Osaka	154	○
	Total 9 properties		927	
2018	S-RESIDENCE Ichikawa-shi Minami-yawata	Ichikawa, Chiba Prefecture	81	○
	S-RESIDENCE Yodogawa-ku Kikawa-Higashi	Yodogawa-ku, Osaka	177	○
	S-RESIDENCE Shinjuku	Shinjuku-ku, Tokyo	65	○
	S-RESIDENCE Matsudo-shi Honcho	Matsudo, Chiba Prefecture	52	○
	S-RESIDENCE Nagoya-shi Higashi-ku	Higashi-ku, Nagoya	95	○
	Total 5 properties		470	
2019	S-RESIDENCE Suita-shi Esakacho	Esakacho, Suita	153	○
	Total 1 property		153	
	Total 15 properties		1,550	

* Listings marked with ○ for first refusal rights are properties for which SRR is granted the first refusal rights. But as of the end of May 2017, there is no agreement with SRR for the sale.
Source: Prepared by FISCO from the Company's results briefing materials

Looking at the development status of investment condominiums, a total of 28 properties (1,532 units) are under development, comprising 11 properties (600 units) scheduled to be completed in 2017, 15 properties (758 units) scheduled to be completed in 2018, and 2 properties (174 units) scheduled to be completed in 2019. Value on an expected sale price basis is approximately ¥31.1bn. There are 20 properties (788 units) in the Tokyo metropolitan area (in Tokyo) and 8 properties (744 units) in the Kansai area (in Osaka).

Development and sales plan for investment condominium sales
(Tokyo metropolitan region/at the end of May 2017)

Fiscal year of completion	Property name (provisional)	Location	No. of units
2017	Chuo-ku Shinkawa 2-chome	Chuo-ku, Tokyo	27
	Shinagawa-ku Minamishinagawa 4-chome	Shinagawa-ku, Tokyo	38
	Sumida-ku Ishiwara 3-chome (Kita)	Sumida-ku, Tokyo	38
	Sumida-ku Ishiwara 3-chome (Minami)	Sumida-ku, Tokyo	42
	Sumida-ku Yokokawa 1-chome	Sumida-ku, Tokyo	39
	Bunkyo-ku Yushima 2-chome	Bunkyo-ku, Tokyo	57
	Koto-ku Hirano 2-chome	Koto-ku, Tokyo	41
	Shinjuku-ku Shinjuku 7-chome	Shinjuku-ku, Tokyo	29
	Total 8 properties		311
2018	Chuo-ku Nihonbashi Hamacho 2-chome	Chuo-ku, Tokyo	30
	Sumida-ku Kinshi 1-chome	Sumida-ku, Tokyo	72
	Nerima-ku Toyotama-Kita 2-chome	Nerima-ku, Tokyo	48
	Bunkyo-ku Koishikawa 5-chome	Bunkyo-ku, Tokyo	27
	Taito-ku Taito 2-chome	Taito-ku, Tokyo	53
	Chuo-ku Tsukishima 3-chome	Chuo-ku, Tokyo	45
	Taito-ku Kuramae 3-chome	Taito-ku, Tokyo	28
	Taito-ku Kojima 1-chome (Nishi)	Taito-ku, Tokyo	38
	Toshima-ku Ikebukuro Honcho 1-chome	Toshima-ku, Tokyo	31
	Toshima-ku Takada 2-chome	Toshima-ku, Tokyo	36
	Chuo-ku Nihonbashi Bakurocho 1-chome	Chuo-ku, Tokyo	35
	Total 11 properties		443
2019	Taito-ku Kojima 1-chome (Higashi)	Taito-ku, Tokyo	34
	Total 1 property		34
	Total 20 properties		788

Note: Expected sale prices are totaled based on the fiscal year when construction is scheduled to be completed, which may differ from the fiscal year when the property is sold. This development plan shows values as of end-May 2017 and is subject to change thereafter.
Source: Prepared by FISCO from the Company's results briefing materials

Development and sales plan for investment condominium sales
(Kansai/at the end of May 2017)

Fiscal year of completion	Property name (provisional)	Location	No. of units
2017	Samty Osaka GRAND EAST	Higashinari-ku, Osaka	144
	Suita-shi Esakacho 1-chome	Esakacho, Suita	65
	Fukushima-ku Yoshino 4-chome	Fukushima-ku, Osaka	80
	Total 3 properties		289
2018	Yodogawa-ku Kikawa-Higashi 2-chome	Yodogawa-ku, Osaka	90
	Yodogawa-ku Nishi-Miyahara 2-chome II	Yodogawa-ku, Osaka	90
	Nishiyodogawa-ku Himesato 2-chome	Nishiyodogawa-ku, Osaka	85
	Nishi-ku Edobori 3-chome II	Nishi-ku, Osaka	50
	Total 4 properties		315
2019	Nishi-ku Honden 1-chome	Nishi-ku, Osaka	140
	Total 1 property		140
	Total 8 properties		744

Note: Expected sale prices are totaled based on the fiscal year when construction is scheduled to be completed, which may differ from the fiscal year when the property is sold. This development plan shows values as of end-May 2017 and is subject to change thereafter.
Source: Prepared by FISCO from the Company's results briefing materials

Outlook

Company raised its full-year FY11/17 forecast

1. FY11/17 forecast

Based on 1H results and recent conditions, the Company raised its FY11/17 earnings forecasts from their original levels. It now forecasts sizable increases in sales and profit, with sales of ¥62,000mn, up 18.3% YoY (¥800mn higher than previous forecast), operating income of ¥10,300mn, up 20.0% (¥1,000mn higher), ordinary income of ¥8,000mn, up 17.8% (¥800mn higher), and profit attributable to owners of parent of ¥5,300mn, up 14.5% (¥500mn higher).

Growth in the Real Estate Business is forecast to contribute significantly to the projected increase in net sales. Meanwhile, In terms of profit and loss, while higher depreciation costs associated with the abovementioned large property acquisition (income property) are expected to have a negative impact on profit, the Company expects to secure higher profits owing to growth in sales and higher sales prices and improve its operating margins slightly to 16.6% (16.4% in FY11/16).

Investment plans call for a total investment of about ¥42.3bn (¥13.0bn lower than the initial plan), comprising investment of about ¥15.8bn in development sites and about ¥26.5bn in income properties. The reason the Company lowered its investment plan (for income properties) is that it factored the possibility of additional bulk acquisitions into its initial plan. However, it decided not to go forward with these acquisitions as it could not secure sufficiently favorable conditions. We therefore do not think lower investment will have an impact on the Company's earnings.

FY11/17 forecast

(¥mn)

	FY11/16 Result		FY11/17 Forecast				Change	
			Initial forecast		After revision			
		% of total		% of total		% of total	Initial forecast	After revision
Net sales	52,409		61,200		62,000		16.8%	18.3%
Real Estate Business	43,783	83.5%	52,900	86.4%	53,300	86.0%	20.8%	21.7%
Property Leasing Business	7,288	13.9%	7,100	11.6%	7,200	11.6%	-2.6%	-1.2%
Other Business	1,853	3.5%	1,600	2.6%	1,880	3.0%	-13.7%	1.5%
Adjusted amount	-515	-	-400	-	-400	-	-	-
Operating income	8,586	16.4%	9,300	15.2%	10,300	16.6%	8.3%	20.0%
Real Estate Business	8,071	18.4%	9,800	18.5%	11,000	20.6%	21.4%	36.3%
Property Leasing Business	2,550	35.0%	2,100	29.6%	2,100	29.2%	-17.7%	-17.6%
Other Business	123	6.6%	200	12.5%	145	7.7%	61.3%	17.9%
Adjusted amount	-2,159	-	-2,800	-	-2,850	-	-	-
Ordinary income	6,788	13.0%	7,200	11.8%	8,000	12.9%	6.1%	17.8%
Profit attributable to owners of parent	4,628	8.8%	4,800	7.8%	5,300	8.5%	3.7%	14.5%

Source: Prepared by FISCO from the Company's financial results and financial results briefing materials

The results outlook for main businesses and the prerequisites for these outlooks to be realized are as follows.

(1) Real Estate Business

In the Real Estate Business, net sales are forecast to increase 21.7% YoY to ¥53,300mn (¥400mn higher than previous forecast) and segment income to increase 36.3% to ¥11,000mn (¥1,200mn higher). The Company expects to sell 7 S-RESIDENCE series properties in development mobilization (8 in initial forecast), and 30 income properties in regeneration mobilization. Plans also call for sales of 15 properties and 650 units in investment condominium sales (14 properties and 600 units). Compared with the initial forecast, the Company now plans to sell one fewer property in development mobilization and one more investment condominium property. This is because one property has been reclassified from development mobilization to investment condominium.

In terms of profit and loss, the Company plans to generate increased profits based on higher sales, along with improving segment income margin to 20.6% (18.4% in the previous fiscal year.)

(2) Property Leasing Business

In the Property Leasing Business, net sales are forecast to decrease 1.2% YoY to ¥7,200mn (¥100mn higher than previous forecast) and segment income to fall 17.6% to ¥2,100mn (unchanged). Leasing income is still projected to decrease owing to the sale of income properties. However, as the timing of income property acquisitions was brought forward, the Company raised its initial forecast for leasing income. In terms of profit and loss, the Company expects segment income to decline owing to higher depreciation costs associated with a large-scale acquisition.

(3) Other Business

In the Other Business, net sales are forecast to increase 1.5% YoY to ¥1,880mn (¥280mn higher than previous forecast), while segment income is forecast to increase 17.9% YoY to ¥145mn (¥55mn lower). While the Company raised its forecast for segment sales on strong construction orders, it lowered its forecast for segment income, factoring in more conservative assumptions for hotel occupancy rates and leasing costs.

Based on 1H results, its pipeline of development sites, and acquisitions of income properties, we believe the Company will be able to reach its targets. We believe market trends and progress toward the Company's targets bear monitoring, as we see further potential upside and earnings growth from FY11/18 onward.

2. Approach to FY11/18

In FY11/18, the Company is targeting net sales of ¥85.0bn (an increase of 37.1% from the FY11/17 forecast), ordinary income of ¥9.0bn (an increase of 12.5% from the FY11/17 forecast), as part of the medium-term management plan. Growth in the Real Estate Business is expected to continue driving the Company's overall growth. However, in order to achieve the FY11/18 targets, the Company will need to achieve a dramatic increase in its business results based on the (revised) business forecasts for FY11/17.

As mentioned above, FISCO believes that there is a high likelihood that the Company will be able to achieve its targets for FY11/18, based on 1) the continuing strong real estate market, 2) the steady accumulation of its pipeline of development properties, and 3) given that its proactive investment plans in FY11/17 will begin contributing to results from FY11/18 onward. Put differently, the degree of achievement of investment plans in FY11/17 will have a significant bearing on business results from FY11/18 onward. Progress on investment plans will need to be monitored closely.

Growth strategy

Aiming for steady medium- to long-term growth by expanding development in regional metropolitan areas

1. Medium-term management plan

The Company's current medium-term business plan covers the five-year period from FY11/16 to FY11/20. The plan targets net sales at the ¥100bn level and ordinary income at the ¥10bn level for FY11/20 amid a favorable external environment (implementation of negative interest rate policy, growth in inbound demand) and factoring in the impact of measures taken by the Company (expansion of area of operations, entry into J-REIT business).

The "Challenge 40" medium-term management plan

	FY11/16 targets	FY11/18 targets	FY11/20 targets
Net sales	¥57bn	¥85bn	¥100bn level
Ordinary income	¥7bn	¥9bn	¥10bn level
EPS	¥194.4	¥240	¥300 or more
ROE	14.9%	15.0%	15% or more
ROA	7.0%	7.0%	7% or more
Equity ratio	23.0%	27.0%	30% or more

Source: Prepared by FISCO based on the Company's medium-term management plan

2. Future direction and progress

As its growth strategy for the future, the Company has set the following three key strategies: (1) Development of a business model centered on SRR, (2) Strategic investment in regional metropolitan areas, and (3) Roll-out of the hotel development business. Also, as its financial targets, it is aiming to maintain its capital efficiency and establish a financial base.

(1) Development of a business model centered on SRR

The Company's policy is to further evolve its business model, in which it is capable of handling every aspect of the property business, from land purchasing and development through to leasing, sales, and after-sales, so it is centered on SRR, which has been smoothly launched. Specifically, in addition to supplying development properties preferentially to SRR, it is aiming to establish a stable fee business through conducting outsourced asset management and property management after it has supplied the properties. In other words, its strategy can be described as connecting the growth of SRR to the growth of the Company. Over the next two to three years, the Company plans to supply properties to SRR, with the aim of increasing SRR's asset balance to around ¥100bn, in conjunction with expanding steady asset management fees.

(2) Strategic investment in regional metropolitan areas

The Company plans to invest a total of approximately ¥300bn in five years. The specific details of its measures are as follows. In FY11/16, purchases amounted to about ¥39.5bn (development sites and income properties), with purchases of about ¥42.3bn planned for FY11/17. Going forward, the Company plans to accelerate the pace of investment further.

a) Expansion of development areas

Up to the present time, developments have been focused in the metropolitan Tokyo region and the Kansai region, but it will expand its development into each branch office region, including Hokkaido, Chubu, and Kyushu.

b) Diversification of development assets

SRR, which targets accommodation assets (rental housing, and real estate in areas adjacent to rental housing, such as hotels and health care facilities), will become able to incorporate hotels (up to 20% of its assets-held balance), and will actively conduct measures for hotel development, centered on each branch office region.

c) For income properties and regeneration real estate, in addition to working to discover properties with high yields in regional metropolitan areas, it will secure cash flow through facilitating turnover.

Investment plans according to area and asset

(¥bn)

	Income properties	Regeneration real estate	S-RESIDENCE (for funds and REIT)	1R for investors	S-PERIA hotels	Total
Hokkaido	16	7	3	-	5	31
Metropolitan Tokyo region	-	11	10	43	19	83
Chubu	21	7	4	3	5	40
Kansai	27	11	17	23	13	91
Kyushu	27	7	6	4	11	55
Total	91	43	40	73	53	300

Source: Prepared by FISCO based on the Company's medium-term management plan

(3) Roll-out of the hotel development business

Within the previously mentioned total investment amount of approximately ¥300bn, the Company plans to invest around ¥53bn in its hotel development business (land + construction expenses). Specifically, it plans to invest ¥5bn in the Hokkaido region (from 2 to 3 properties), ¥19bn in the metropolitan Tokyo region (around 10 properties), ¥5bn in the Chubu region (from 2 to 3 properties), ¥13bn in the Kansai region (from 5 to 6 properties), and ¥11bn in the Kyushu region (around 5 properties). In addition to developing S-PERIA hotels as a new brand name, it intends to capture both business and inbound demand. As mentioned earlier, the Company secured sites for three properties in Tokyo, Osaka and Fukuoka in the previous fiscal year. However, the Company plans to proceed cautiously with investments in the hotel development business only after carefully selecting properties based on the area.

(4) Financial strategy

The Company's policy is to realize sustainable growth while maintaining a certain level of financial soundness. Specifically, for FY11/20, on the one hand it is aiming for an equity ratio of 30% or more, while on the other hand it intends to maintain capital efficiency with ROE of 15% or more and ROA of 7% or more. It also targets cutting the cost of interest-bearing debts and a net D/E ratio of 2.0 or less.

(5) Other

The Company will also work to enter overseas businesses. As part of these efforts, in September 2016, the Company made an investment (US$5 million) in a fund targeting investments in real estate companies undertaking real estate development and leasing businesses in Ho Chi Minh City, a major city in Vietnam. Using this investment as a foothold for its overseas businesses, the Company will strive to drive further overseas business expansion primarily in Southeast Asian countries, which offer prospects for high growth, with the view to conducting joint development with local companies and other partners, purchasing and owning leasing properties and opening overseas branches or setting up subsidiaries.

Returns to shareholders

Raised FY11/17 dividend forecast. Now targeting annual dividend of ¥42 per share, up ¥9 YoY (¥6 above previous forecast)

The Company is aware that returning profits to shareholders is one of its most important management issues. Its policy is to pay dividends that reflect its results and also based on a comprehensive consideration of its future business plans and financial condition.

Along with the upward revision to the Company's FY11/17 earnings forecast, it has also raised its year-end dividend forecast to ¥42 per share (estimated dividend payout ratio of 18.8%). This is an increase of ¥9 YoY and ¥6 above its previous forecast.

The Company is targeting a dividend payout ratio of 30% by FY11/20. At FISCO, we think that there is still considerable room for the Company to increase dividends through profit growth and raising the dividend payout ratio.

It also aims to improve shareholder value by increasing EPS.

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